IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No.4 of 1991

For Approval and Signature:

HON'BLE MR.JUSTICE D.H.WAGHELA Sd/-
and
HON'BLE MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME-TAX

Versus

KARAMCHAND PREMCHAND PVT LTD

Appearance:

1. INCOME TAX REFERENCE No. 4 of 1991

MR MANISH R BHATT for Petitioner No. 1

MR BD KARIA for MR RK PATEL for Respondent No. 1

CORAM : HON'BLE MR.JUSTICE D.H.WAGHELA

and

HON'BLE MR.JUSTICE D.A.MEHTA

Date of decision: 28/08/2003

ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE D.A.MEHTA)

1. These are cross references made by the Income Tax Appellate Tribunal, Ahmedabad Bench 'B' under Section 256(2) of the Income Tax Act, 1961 (for short 'the Act').

2. The Assessment Year is 1971-72 and the relevant accounting period is year ended 31-03-1971. The assessee

is a Limited Company. The assessee made a provision of Rs.16,93,186/= on account of gratuity but the same was disallowed by the Income Tax Officer on the ground that no approved gratuity fund had been set up by the assessee as required under the Act.

3. The assessee carried the matter in appeal before the Appellate Assistant Commissioner (A.A.C.) and contended that the assessee had provided for the gratuity liability on the basis of agreement entered into by the assessee - Company with the union of the employees. That the assessee was maintaining its books of account on mercantile basis and the liability, being a contractual liability, was allowable as a deduction against the taxable income. It was further urged that in these circumstances setting up and maintaining an approved gratuity fund was not necessary. The A.A.C. upheld the claim in principle but directed the I.T.O. to grant deduction on the basis of actuarial valuation.

4. The revenue carried the matter in appeal before the Tribunal and contended that the assessee had changed its "method of accounting" from cash to mercantile and that such change was not a bona fide change. In the meantime, the assessee had obtained actuarial valuation and hence, enlarged its claim on basis of the certificate of Actuary to the tune of Rs.41,05,760/=. The Tribunal, for the reason stated in its order dated 31-03-1977, set aside the order of A.A.C. and restored the matter to his file for consideration of the following four points :

"1) Whether any change in the method of accounting was involved and if so, whether the change was justified.

2) Whether the appellant's claim for a lower amount was as a result of a bonafide mistake and whether the appellant could be permitted to raise a fresh claim involving a higher amount.

3) aspect of the change in law from A.Y. 1973-74.

4) Adequate directions to be given to ensure that the appellant did not get the benefit of double deduction, once on the basis of provision and again on the basis of payment subsequently. "

5. The appeal was accordingly heard by the Commissioner of Income Tax (Appeals) who had by then been

vested with the jurisdiction. The Commissioner (Appeals) decided the points as under :-

"1. There was no change in the method of accounting since the cash system was part of the larger mercantile system itself. The decision of the Supreme Court in the case of C.I.T. Vs. Krishnashaswamy Mudaliar (A) (1964) 53 ITR 122 (SC) was relied upon. Even if it was presumed that there was a change it was a bonafide one since the assessee was following the more scientific method of actuarial valuation.

2. The claim for a higher amount was justified in view of the reasons stated in (1).

3. The subsequent change in the law from A.Y. 1973-74 had no effect since the assessment year involved was 1971-72.

4. Actual payments made during a year were not to be allowed while making an allowance of the incremental liability as calculated by the actuary. "

6. The Tribunal in the impugned order dated 18-09-1987 approved the findings of the C.I.T. (Appeals) in so far as they pertain to aforestated four issues. However, the Tribunal did not agree with the reason of the C.I.T. (Appeals) to the effect that the assessee was entitled to deduction of the entire amount as certified by the actuary. According to the Tribunal, the assessee was entitled to only incremental liability for the year under consideration and that too on the basis of an actuarial valuation. The Tribunal further held that such a figure may be either on the lower side or on the higher side than the original provision of Rs.16,93,186/= made by the assessee in its books of account.

7. Being aggrieved both the revenue and the assessee have come up in reference and the following questions have been referred to us by the Tribunal :

"At the instance of the CIT :

Whether, the Appellate Tribunal is right in law in holding that the assessee was entitled to the incremental liability for the year under

consideration and that also on the basis of an actuarial valuation ?"

"At the instance of the assessee :

(1) Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that the CIT(A) had erred in allowing the entire claim of Rs.41,05,760/= in respect of the gratuity and that the assessee would be entitled to only the incremental liability for the year under consideration on the basis of an actuarial valuation ?

(2) Whether on the facts and in the circumstances of the case, the Tribunal having once agreed with the findings recorded by the CIT(A) on the four issues, which were specifically remanded by the Tribunal in the first round, it would have gone further to hold that the provision in question did not pertain to the accounting period in question and involve provision for preceding year also?

(3) Whether on the facts and in the circumstances of the case, the Tribunal, having upheld the finding of the CIT(A) to the effect that there was no change in the method of account, as stated in paragraph - 12 of its order, it could have come to the conclusion that all that the assessee had done was to change the method by claiming the deduction on the basis of actuarial valuation as stated in paragraph 20 of its order ?

(4) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in applying the various decisions to hold that the assessee was not entitled to the entire claim of Rs.41,05,760/= in respect of gratuity aminating from the agreement with the employes Union ?"

8. Mr.T.U.Bhatt, learned advocate appearing on behalf of the revenue, contended that as the assessee had not set up gratuity fund the Tribunal was in error in

holding that the assessee was entitled to deduction of gratuity liability. According to Mr.Bhatt, no amount could have been allowed as the deduction and the Tribunal had committed an error in law while holding that the assessee was entitled to deduction of incremental liability and that too on the basis of an actuarial valuation. At the same time Mr.Bhatt also submitted that the claim of the assessee in relation to liability other than the incremental liability had rightly been disallowed by the Tribunal and the questions referred to, at the instance of the assessee, were required to be decided against the assessee and Tribunal's order to that extent had to be upheld.

9. Mr.B.D.Karia, learned advocate appearing on behalf of the assessee, submitted that the position in law is well settled and the Tribunal's order, upholding claim of deduction of incremental liability, should not be interfered with and the revenue's reference was required to be rejected. It was submitted that the Tribunal's order in so far as it denied the claim in relation to the balance liability worked out on the basis of actuarial valuation was incorrect and an impassioned plea was made with reference to the said pleadings. It was submitted that till the point of time the assessee obtained actuarial valuation i.e. till the year under consideration, the assessee was following cash system of accounting for the purposes of claiming deduction in relation to gratuity liability and it was only for the first time on the basis of mercantile system of accounting that the assessee had made a claim for the year under consideration. It was further urged that in the circumstances, once the change in method of accounting has been accepted as a bona fide change it was apparent that this was the only year in which the assessee could make a claim and the assessee could not have made any claim in any of the prior years. It was further submitted that once the Tribunal had directed the appellate authority to record its findings on the four issues, it was not open to the Tribunal to record any decision beyond the four issues in the second round, especially after the appellate authority viz. C.I.T. (Appeals), having held in favour of the assessee on all the four issues. In support of various submissions reliance was placed on decision of this Court in the case SAURASHTRA CEMENT AND CHEMICAL INDUSTRIES LTD. V. COMMISSIONER OF INCOME-TAX, [1995] 213 I.T.R. 523.

10. Having heard both the sides we do not find any infirmity in the findings and reasoning of the Tribunal so as to interfere in relation to any of the questions

referred to us. The Tribunal has found, as a matter of fact, that the assessee had entered into an agreement on 06-09-1967 with the union of employees and it was on the basis of the said contract that the liability to pay gratuity arose for the first time. The Tribunal has also found that on the basis of the said agreement on and from Assessment Year 1968-69 the assessee had been claiming deduction of gratuity liability on the basis of actual disbursement / payments made as and when the event on the basis of which gratuity became payable occurred. That it was for the first time in the year under consideration viz. Assessment Year 1971-72 that the assessee has opted to make a provision by changing its method of accounting resulting in the assessee making a claim of cumulative liability for various years preceding the Assessment Year 1971-72. The Tribunal has taken into consideration the settled legal position whereunder it is stated that gratuity liability based on actuarial valuation can be charged against the income of the year so as to work out the correct profits of the year. The legal principle recognized and laid down is that a Company is entitled to charge against each year's receipts the cost of making provision for the retirement payments which would ultimately be payable by the Company as the Company had had the benefit of the employees' services during that year, provided the present value of the future payments could be fairly estimated. And this is the basis for obtaining an actuarial valuation. It is a liability in praesenti though relatable to payments to be made in future upon happening of a stipulated event. In the case of METAL BOX COMPANY OF INDIA LTD. VS. THEIR WORKMEN, [1969] 73 I.T.R. 53, the Supreme Court has stated thus at pages 62-63 :

> "In the case of an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid. Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business."

11. This decision of the Apex Court has consistently

been followed and there is no change in the legal position. In the case of NAGRI MILLS CO. LTD. V. COMMISSIONER OF INCOME-TAX, GUJARAT, [1981] 131 I.T.R. 257, this Court, after applying the aforesaid principle laid down by the Apex Court, upheld the claim of incremental gratuity liability in the year under consideration holding that the assessee is entitled under Section 28 of the Act to deduct the cost of making provision for its liability towards gratuity.

12. Reliance on behalf of the assessee on the decision of SAURASHTRA CEMENT AND CHEMICAL INDUSTRIES LTD. (supra) is misplaced and does not assist the case of the assessee. In the said decision it has been specifically laid down that merely because an expense relates to a transaction of an earlier year it does not become a liability payable in the earlier year unless it can be said that the liability was determined and crystallized in the year in question on the basis of maintaining accounts on the mercantile basis. Therefore, what is to be ascertained is as to whether it can be said that liability was determined and crystallized in the year under consideration or had it already been determined and crystallized in any earlier year on the basis of method of accounting. In the present case, admittedly, the liability arose, for the first time, by virtue of the agreement dated 06-09-1987 and that was the point of time when the liability to pay gratuity upon happening of an event accrued for the first time. Thereafter, it was always open to the assessee to seek appropriate deduction against profits of each year, while computing the taxable income, the liability in present year, pertaining to that year, on the basis of actuarial valuation. The fact that the assessee chose not to do so viz. make claim from year to year, or failed to make a claim, for whatsoever reason, cannot make the accrual of liability a non-accrual and permit the assessee to make a claim in the year under consideration taking into account the entire liability as on 31-03-1971. The assessee would be entitled to claim deduction only in relation to liability as on 31-03-1971 after deducting the liability as on 31-03-1970 i.e. incremental liability for the year under consideration. We, therefore, do not find any reason to interfere with the finding of the Tribunal on this aspect of the matter. The question referred to us, at the instance of C.I.T., is answered in the affirmative i.e. against the revenue and in favour of the assessee.

13. Question No.1 referred to us, at the instance of the assessee, is answered in the affirmative i.e. in favour of the revenue and against the assessee. In light

of our answer to question No.1, at the instance of the assessee, it is not necessary to answer question Nos.2, 3 and 4 as they are merely aspects of the same controversy and covered by our answer to question No.1.

14. In the result, the references, at the instance of the revenue and at the instance of the assessee, stand answered accordingly.

15. The reference stands disposed of with no order as to costs.

Sd/- Sd/-

[D.H.WAGHELA, J] [D.A.MEHTA, J]

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